

Message Text

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LIMDIS

FOR ARA AMBASSADOR STEDMAN

E.O. 11652: GDS
TAGS: ECON EALR PE
SUBJECT: PERU'S FINANCIAL CRISIS

REFS: (A) LIMA 5570; (B) LIMA 5481; (C) LIMA 6741; (D) LIMA 7115

1. SUMMARY: THIS CABLE SUMMARIZES AND BRING S UP TO DATE MY VIEWS ON THE PERUVIAN FINANCIAL CRISIS AND WHAT WE SHOULD DO ABOUT IT. THE DECISION NOT TO GO THROUGH WITH THE PIAZZA/IMF PROGRAM OF TOUGH AUSTERITY WAS TAKEN AS A RESULT OF THE GOP'S CONCLUSION THAT THE SOCIAL AND POLITICAL COSTS WOULD BE TOO HIGH. I BELIEVE THAT CONCLUSION WAS PROBABLY CORRECT. MORALES BERMUDEZ HAS NOT SO FAR SUCCUMBED TO THE TEMPTATION OF THE PRINTING PRESS. HE IS TRYING TO PURSUE AUSTERITY AND SENSIBLE ECONOMIC POLIFICES TO THE DEGREE HIS PERCEPTION OF THE POLITICAL REALITIES PERMITS. I BELIEVE HE DESERVES WHATEVER HELP WE CAN GIVE HIM. THE CURRENT PRESIDENT IS THE BEST -- AND PERHAPS THE ONLY -- HOPE FOR A PEACEFUL AND ORDERLY TRANSITION TO DEMOCRATIC GOVERNMENT.
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THE CRISIS THREATENS HIS POSITION AS IT THREATENS THE POLITICAL PROCESS HE HAS LAUNCHED. DESPITE THE GOP'S OBVIOUS DEFICIENCIES, THE UNCERTAIN OUTLOOK FOR THE ACHIEVEMENT OF FINANCIAL STABILITY AND THE OBSTACLES WE FACE IN TRYING TO HELP, AN AFFIRMATIVE POLICY OF USG SUPPORT SEEMS TO ME CALLED FOR IN TERMS OF OUR POSITIVE APPROACH TO THE PROMOTION OF HUMAN RIGHTS. END SUMMARY.

2. I OFFERED MY VIEWS ON THE CRISIS AND HOW THE USG SHOULD REACT TO IT IN THE TELEGRAMS UNDER REFERENCE. IT MIGHT BE USEFUL NOW TO SUMMARIZE THE POINTS I HAVE TRIED TO MAKE AND TO BRING YOU UP TO DATE ON HOW THE SITUATION LOOKS FROM MY VANTAGE POINT.

3. FIRST, I AM PERSUADED THAT THE MILITARY GOVERNMENT'S RETREAT FROM THE PIAZZA/IMF PROGRAM WAS NEITHER CAPRICIOUS NOR IRRESPONSIBLE. THE STRIKES AND DEMONSTRATIONS IN JUNE AND JULY INDICATED A DANGEROUS DEGREE OF SOCIAL UNREST ENGENDERED TO A CONSIDERABLE EXTENT BY THE FACT THAT AUSTERITY HAD ALREADY PRODUCED A SHARP DECLINE IN LIVING STANDARDS AMONG THE POOR MAJORITY -- AND EVEN HUNGER AS THE CARDINAL HAS POINTED OUT. (IT IS ALSO TRUE THAT AGITATORS OF THE EXTREME LEFT PLAYED A PART. THAT THESE SAME ELEMENTS WERE SUBSIDIZED DURING THE VELASCO YEARS INTO POSITIONS OF INFLUENCE IN LABOR AND POPULAR ORGANIZATIONS AS A MEANS OF COUNTERING APRA IS JUST ANOTHER CROSS THE CURRENT GOVERNMENT MUST BEAR.)

4. PEOPLE WERE KILLED IN THE DISTURBANCES; AND THE GOVERNMENT FOUND ITSELF IMPELLED TO ADOPT REPRESSIVE MEASURES TO CONTROL THE SITUATION, JAILING STRIKE LEADERS AND PERMITTING EMPLOYERS TO FIRE "AGITATORS" WITHOUT FURTHER CAUSE. ANOTHER LARGE DOSE OF AUSTERITY
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MUST HAVE SEEMED AT THIS POINT TO MORALES BERMUDEZ AND HIS COLLEAGUES A SURE RECIPE FOR CONTINUING CYCLES OF UNREST AND REPRESSION. AND I DO NOT BELIEVE THAT THE PRESIDENT'S FEARS OF A "SOCIAL EXPLOSION" OR HIS PERCEPTION OF THE CONFLICT BETWEEN HUMAN RIGHTS CONCERNS AND ECONOMIC ORTHODOXY WERE LIGHTLY CONCEIVED.

5. THE TEMPTATION MUST HAVE BEEN STRONG AFTER PIAZZA'S FALL TO LOOSEN UP ON THE BUDGET AND PUMP LARGE AMOUNTS OF MONEY INTO THE ECONOMY. AS I THINK MY COMMENTS AT THE TIME INDICATED, IT DID NOT APPEAR FROM HERE THAT THERE WOULD BE A VERY REALISTIC OPPORTUNITY FOR USG SUPPORT OR ASSISTANCE IN THE EVENT THAT COURSE WERE ADOPTED. BUT IN FACT THE GOP HAS SO FAR RESISTED THE TEMPTATION TO A LAUDABLE DEGREE. A ONE-TIME EMISSION OF SOME 5 BILLION SOLES TO PAY INTERNAL GOVERNMENT BILLS WAS COUNTERED BY AN INCREASE IN RESERVE REQUIREMENTS. MONEY REMAINS EXTREMELY TIGHT AND THE MINISTERS I SEE ALL INSIST THAT THEIR BUDGETS HAVE BEEN CUT TO THE BONE, A VIEW ECHOED PUBLICLY IN THE PRESS RECENTLY BY NAVY MINISTER PARODI. I AM NOT SAYING THAT FISCAL AND MONETARY POLICY IS ABOUT TO MEET THE FUND'S TOUGHER CRITERIA.

BUT IT DOES SEEM THAT THE GOP IS MAKING A GENUINE EFFORT
WITHIN WHAT IT PERCEIVES AS THE POLITICAL REALITIES TO
MAINTAIN AUSTERITY AND MANAGE ITS AFFAIRS IN A
RESPONSIBLE FASHION.

6. THE FOREGOING IS AT LEAST MY IMPRESSION AS OF THE
MOMENT. WE SHOULD KNOW MORE ABOUT WHAT THE GOP PLANS
AFTER THE PERUVIAN TEAMS MEET WITH THE BANKS AND THE
FUND. I RECOGNIZE THAT THE APPARENT DECISION TO MAINTAIN
A FIXED EXCHANGE RATE FOR SOME TIME AND TO TIE UP IMPORTS
IN RED TAPE ARE DUBIOUS INITIATIVES TO SAY THE LEAST.
BUT I THINK THESE ARE MATTERS THAT MAY BE OPEN TO NEGOTIATION
IN TIME. WHAT COUNTS IS THE UNDERSTANDING I
HAVE HERE OF WHAT THE REAL PROBLEMS ARE AND THE DIS-
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POSITION TO WORK TOWARD RESOLVING THEM.

7. AS I HAVE SAID BEFORE, I THINK WE HAVE A GOOD DEAL
AT STAKE IN THIS PROCESS. MORALES BERMUDEZ IN MY JUDGMENT
IS PERSONALLY COMMITTED TO A DEMOCRATIC TRANSFER
BY 1980. HE AND MOST OF HIS COLLEAGUES STRIKE ME AS
ENTIRELY SINCERE IN WANTING AT ALL COSTS TO AVOID
EMPLOYING THE KIND OF REPRESSION WE HAVE SEEN ELSEWHERE
ON THIS CONTINENT. AND THEY CONTINUALLY EMPHASIZE THEIR
INTENTION TO SEE THAT THE SOCIAL REFORMS OF THE REVOLUTION
ARE MAINTAINED. (IF ONLY VERY FEW PEOPLE HERE
WHO ARGUE THAT VELASCO'S ASSAULT ON THE TRADITIONAL
PERUVIAN SOCIAL SYSTEM WAS WITHOUT REASON OR OTHER
THAN OVERDUE.) THESE OBJECTIVES COINCIDE WITH THE
CARTER ADMINISTRATION'S PRIORITIES AND I UNDERSTAND THEM.

8. BUT THE FINANCIAL CRISIS THREATENS THE GOP'S BEST INTENTIONS.
AS MINISTER OF INDUSTRIES IBANEZ NOTED TO ME, THE
GOVERNMENT'S AUTHORITY AND PRESTIGE ARE "WEARING AWAY".
THE STRAINS AND PRESSURES ARE SURE TO MOUNT THE LONGER
THE SPECTER OF INTERNATIONAL DEFAULT PERSISTS. AGREEMENT
WITH THE FUND AND/OR THE BANKS, HOWEVER PARTIAL,
WOULD DISSIPATE MUCH OF THIS AND STRENGTHEN THE
PRESIDENT'S HAND. JUAN DE ONIS HAS OBSERVED THAT THE
PERUVIAN SITUATION IS NOW AT A POINT THAT IN THE CLASSIC
LATIN AMERICAN PATTERN COULD BE EXPECTED TO PRODUCE A
MILITARY TAKEOVER. IT IS TRUE THAT THAT SOLUTION IS
NOT AVAILABLE IN ITS PUREST FORM; BUT THEN THERE ARE
ALWAYS OTHER MILITARY OFFICERS IN THE WINGS
DISPOSED TO TRY THEIR HAND. WE CANNOT PREDICT WHAT PRECISELY WOULD
HAPPEN HERE IF MORALES BERMUDEZ WERE TO FAIL. BUT IT
PROBABLY WOULD NOT BE TO OUR LIKING. AND I AM OF THE
OPINION THAT HE IS THE BEST PERCEIVABLE HOPE FOR A
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PEACEFUL AND ORDERLY TRANSITION TO A DEMOCRATIC AND
CIVILIAN GOVERNMENT.

9. THE FOREGOING ANALYSIS LEADS ME TO THE CONCLUSION THAT WE
SHOULD DO WHATEVER WE REASONABLY CAN TO HELP THE GOP
SURMOUNT THIS CRISIS. I AM AWARE OF THE OBSTACLES,
PARTICULARLY OUR LIMITED INFLUENCE WITH THE FUND.
THERE IS ALSO THE QUESTION OF ARMAMENTS AND THE WISDOM
OF OFFERING SUPPORT TO A GOVERNMENT THAT WASTES RE-
SOURCES ON THEM. BUT HERE I WAS STRUCK BY THE PRESI-
DENT'S STATEMENT TO CODELS YATRON AND WOLFF THAT PERU
SHOULD BE ABLE TO ENJOY A "BREATHING SPACE" OF 10 TO
15 YEARS IN ARMS PURCHASES (LIMA 7012). IN ADDITION,
SOME DOUBT ARISES AS TO WHETHER THIS GOVERNMENT HAS THE
STRENGTH, COHESION OR WILL TO FOLLOW THROUGH ON THE
DIFFICULT MEASURES NEEDED TO PULL PERU OUT OF THE HOLE
IT IS IN. HOWEVER NONE OF THIS SEEMS TO ME CAUSE FOR NOT
MOVING AHEAD TO WORK WITH THE GOP ON ITS PROBLEMS.
WE SEEK A POSITIVE APPROACH TO THE DEFENSE OF HUMAN
RIGHTS IN THE REGION. FOR THIS SITUATION THAT MEANS
TO ME A POLICY OF AFFIRMATIVE AND ACTIVE SUPPORT FOR
THE GOP DURING THIS PERIOD OF DIFFICULT TRANSITION.
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